[JOINT COMMITTEE PRINT]

DESCRIPTION OF LAW AND BILLS

RELATING TO

CLASSIFICATION OF EMPLOYEES AND INDEPENDENT CONTRACTORS FOR TAX PURPOSES

(H..R 4531, H.R. 4971, H.R. 5729, H.R. 5867, and H.R. 6311)

SCHEDULED FOR A HEARING

BY THE

SUBCOMMITTEE ON SELECT REVENUE MEASURES

OF THE

COMMITTEE ON WAYS AND MEANS

HOUSE OF REPRESENTATIVES

ON JUNE 11, 1982

PREPARED FOR THE USE OF THE

COMMITTEE ON WAYS AND MEANS

BY THE STAFF OF THE

JOINT COMMITTEE ON TAXATION

JUNE 9, 1982

U.S. GOVERNMENT PRINTING OFFICE

91-495 O WASHINGTON: 1982 JCS-21-82

J862-21
H782-18

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INTRODUCTION

The Ways and Means Subcommittee on Select Revenue Measures has scheduled a hearing on June 11, 1982, on legislative proposals relating to the classification of workers for Federal employment tax purposes. The purpose of the hearing is to examine the classification issue and current, as well as prior, legislative proposals. The current proposals are H.R. 4531 (Messrs. Conable, Duncan, Frenzel, Jenkins, Martin (of N.C.), and others); H.R. 4971 (Mr. Crane (of Ill.)); H.R. 5729 (Messrs. Gephardt, Duncan, Bafalis, and others); H.R. 5867 (Mr. Guarini); and H.R. 6311 (Messrs. Gephardt, Conable, Heftel, and Hance). H.R. 5867 is the same as H.R. 5460 (Mr. Rostenkowski and others) in the 96th Congress, as reported (in 1979) by the Subcommittee.

This pamphlet, prepared in connection with the hearing, is divided into four parts. The first part is a brief summary of present law, background, and legislative proposals. The second part is a discussion of present law. The third part discusses the background of the independent contractor/employee controversy which led to the current legislative proposals. This part includes a discussion of the interim relief provided by the Revenue Act of 1978, and subsequently extended through June 30, 1982. The fourth part provides a description of the provisions in current legislative proposals that relate to the classification of individuals for Federal employment tax purposes.

Three of these proposals (H.R. 4531, H.R. 5867, and H.R. 6311) also contain provisions which are directed specifically toward improving the income and employment tax compliance of independent contractors. Those provisions are described in JCX–18–82, "Comparative Description of the Provisions of H.R. 6300, H.R. 5829, H.R. 6311, and H.R. 5867 Relating to Expanded Information Reporting Requirements for Payments to Nonemployees, Increased Penalties for Failure to Report Certain Information, and Withholding," which was prepared in connection with a hearing on compliance issues held by the Ways and Means Committee on May 18, 1982. The penalty provisions of H.R. 4531 are similar to those contained in H.R. 5867.

I. SUMMARY

A. Present Law

Determination of status

Under present law, the classification of particular workers as employees or independent contractors for Federal income and employment tax purposes generally is determined under common law (i.e., nonstatutory) rules. Under the common law, if a person engaging the services of another has "the right to control and direct the individual who performs the services, not only as to the result to be accomplished by the work but also as to the details and means by which the result is to be accomplished," the relationship of employer and employee exists.

Social Security (FICA) taxes

For the calendar year 1982, employers and employees are required by the Federal Insurance Contributions Act to pay social security (FICA) taxes of 6.70 percent each on the first $32,400 of the employee's wages, for a maximum of $2,170.80 each and a total of $4,341.60 per employee.

Federal Unemployment Tax Act (FUTA) taxes

The FUTA tax is levied on covered employers at a current rate of 3.4 percent on wages up to $6,000 per year paid to an employee. However, a 2.7 percent credit is provided to employers who pay taxes under approved State unemployment compensation programs.

Federal income tax withholding

In addition to the responsibility for FICA and FUTA taxes, an employer who pays wages to an employee must withhold for each pay period a portion of the wages to satisfy all, or part, of the employee's Federal income tax liability.

Taxes on self-employed individuals

Compensation paid to individuals who are self-employed is not subject to Federal income tax withholding. Rather, self-employed individuals generally must make quarterly payments of estimated tax directly to the Treasury.

For calendar year 1982, self-employed individuals with net self-employment earnings of $400 or more are required by the Self-Employment Contributions Act to pay social security (SECA) tax of 9.35 percent on earnings up to $32,400, for a maximum SECA tax of $3,029.40. Self-employed persons are not subject to FICA or FUTA taxes.

B. Background

Increased IRS enforcement

In the late 1960's, the Internal Revenue Service increased audits of employment taxes. As a result, controversies developed between the Service and some taxpayers concerning the proper classification of workers, including insurance agents, direct sellers, pollsters, oil jobbers, and real estate agents.

If the Service were to prevail in reclassifying a worker as an employee for past pay periods, the taxpayer would become liable for employment taxes (withholding, social security, and unemployment) with respect to the reclassified worker.

Revenue Act of 1978

The Revenue Act of 1978 provided interim relief for certain taxpayers involved in employment tax status controversies with the Service. In general, the Act terminated a taxpayer's potential liabilities for Federal income tax withholding, social security, and FUTA taxes in cases where the taxpayer has a reasonable basis for treating workers other than as employees. In addition, the Act prohibited the issuance of Treasury regulations and revenue rulings on common law employment status.

The interim relief provisions of the 1978 Act, after extensions by Public Law 96–167 and Public Law 96–541, currently are in effect through June 30, 1982.

C. Legislative Proposals*

H.R. 4531

The bill would provide a statutory safe-harbor test for determining the status of individuals for Federal employment tax purposes; would provide separate reporting requirements for payments made to independent contractors; and would provide a new penalty for recurring failures to comply with the information reporting requirements. In addition, the bill would give the Tax Court jurisdiction to hear certain employment tax disputes. The provisions of the bill would apply to payments after June 30, 1981.

H.R. 4971

The bill would establish three alternative tests for determining the status of individuals for purposes of the Federal employment tax laws. An individual would qualify as an independent contractor if all the requirements of any one of the three tests were met. In addition, the bill would require the Treasury Department to report to the tax-writing committees on the tax compliance of independent contractors. The bill would apply to services performed after December 31, 1981.

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*The non-safe-harbor provisions of H.R. 5867 and H.R. 6311 are described in JCX–18–82, "Comparative Description of the Provisions of H.R. 6300, H.R. 5829, H.R. 6311, and H.R. 5867 Relating to Expanded Information Reporting Requirements for Payments to Nonemployees, Increased Penalties for Failure to Report Certain Information, and Withholding," which was prepared in connection with the Ways and Means Committee hearing on compliance issues held on May 18, 1982. The penalty provisions of H.R. 4531 are similar to those contained in H.R. 5867.

H.R. 5729

The bill would provide a statutory safe-harbor test that, if met, would result in the classification of an individual as an independent contractor. The bill would apply to services performed after December 31, 1981.

H.R. 5867

The bill would provide a statutory safe-harbor test for determining the status of individuals for Federal employment tax purposes; would provide separate reporting requirements for payments made to independent contractors and sales made to direct sellers; and would provide a new penalty for recurring failures to file information returns. In addition, the bill would require withholding at a flat 10-percent rate on compensation paid to certain independent contractors. The bill would apply to payments after June 30, 1982.

H.R. 5867 is the same (except for the effective date) as H.R. 5460 of the 96th Congress (as reported by the Subcommittee on Select Revenue Measures).

H.R. 6311

The bill would provide a statutory safe-harbor test under which certain workers would be treated as independent contractors for Federal employment tax purposes; would impose specific information reporting requirements on persons who make payments to independent contractors; would provide new reporting requirements for persons who sell consumer products to buyers for resale in the home; and would provide new penalties for failures to report independent contractor payments and for failures to report direct sales. Furthermore, the bill would impose a withholding requirement in certain situations involving the failure of payees to provide payors with identification numbers.

The safe-harbor test generally would apply to services performed after the earlier of June 30, 1982, or the date of enactment. The new penalties and reporting requirements generally would apply to payments made after 1982. However, the reporting requirements for direct sales would apply to sales after 1983. The new withholding provisions would apply to payments made after 1983.

II. PRESENT LAW

A. Classification of Individuals as Employees or Independent Contractors

Overview

Under present law, common law (i.e., nonstatutory) rules generally apply to determine whether particular workers are treated as employees or independent contractors (self-employed persons) for purposes of Federal employment taxes.[1] The determination of an employer-employee relationship is important because wages paid to employees generally are subject to social security taxes imposed on the employer and the employee under the Federal Insurance Contributions Act (FICA) and to unemployment taxes imposed on the employer under the Federal Unemployment Tax Act (FUTA). Compensation paid to independent contractors is subject to the tax on self-employment income (SECA), but not to FICA or FUTA taxes. In addition, Federal income tax must be withheld from compensation paid to employees, but payments to independent contractors are not subject to withholding.

The Internal Revenue Code generally defines an employee as "any individual who, under the usual common law rules applicable in determining the employer-employee relationship, has the status of an employee."[2]

Under the common law test, an employer-employee relationship generally "exists when the person for whom services are performed has the right to control and direct the individual who performs the services, not only as to the result to be accomplished by the work but also as to the details and means by which that result is accomplished. That is, an employee is subject to the will and control of the employer not only as to what shall be done but how it shall be done."[3] Thus, the most important factor under the common law is the degree of control, or right of control, which the employer has over the manner in which the worker is to perform services for the employer.

Consideration of various factors

In determining whether the necessary degree of control exists in order to find that an individual has common law employee status, the courts and the Internal Revenue Service ordinarily consider a number of factors. Because the basic issue of an individual's employment status is a factual matter, the use of these factors requires more than a mechanical comparison of the number of items which do, or do not, indicate the presence or absence of an employer-employee relationship.

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[1] Code sec. 3121(d)(3) (relating to statutory employees under the Federal Insurance Contributions Act) establishes four categories of statutory employees: certain agent-drivers or commission-drivers; full-time life insurance salesmen; home workers performing services on goods or materials; and full-time traveling or city salesmen. See also Code secs. 3306(i) and 1402(d).

[2] Code secs. 3121(d)(2) (FICA), 3306(i) (FUTA), and 1402(d) (SECA).

[3] See Reg. § 31.3401(c)-1(b).

No single factor generally is dispositive of the issue. Instead, all of the facts of a particular situation must be evaluated and weighed in light of the presence or absence of the various pertinent characteristics. The decision as to the weight to be accorded to any single factor necessarily depends upon both the activity under consideration and the purpose underlying the use of that factor as an element of the classification decision. Because of the particular attributes of a specific occupation, any single factor may be inapplicable.

List of common law factors

The 20 common law factors [4] generally considered in determining whether an employer-employee relationship exists are directed at the following questions:

1. Is the individual providing services required to comply with instructions concerning when, where, and how the work is to be done?
2. Is the individual provided with training to enable him or her to perform a job in a particular manner or method?
3. Are the services performed by the individual integrated into the business' operations?
4. Must the services be rendered personally?
5. Does the business hire, supervise, or pay assistants to help the individual performing services under contract?
6. Is the relationship between the individual and the person for whom he or she performs services a continuing relationship?
7. Who sets the hours of work?
8. Is the individual required to devote full time to the person for whom he or she performs services?
9. Does the individual perform work on another's business premises?
10. Who directs the order or sequence in which the work must be done?
11. Are regular oral or written reports required?
12. What is the method of payment—hourly, weekly, commission, or by the job?
13. Are business or traveling expenses reimbursed?
14. Who furnishes tools and materials necessary for the provision of services?
15. Does the individual performing services have a significant investment in facilities used to perform services?
16. Can the individual providing services realize both a profit or loss?
17. Can the individual providing services work for a number of firms at the same time?
18. Does the individual make his or her services available to the general public?
19. Is the individual providing services subject to dismissal for reasons other than nonperformance of contract specifications?
20. Can the individual providing services terminate his or her relationship at any time without incurring a liability for failure to complete a job?

[4] The 20 common law factors are set forth in the following Internal Revenue Service documents: Exhibit 4640–1. Internal Revenue Manual 8463 and Chapter 2. "Employer-Employee Relationships," Training 3142–01 (Rev. 5–71).

B. Differences in Tax Liabilities Resulting From Classification as an Employee or Independent Contractor

1. Employees

FICA tax

The Federal Insurance Contributions Act (Code secs. 3101–3126) imposes two taxes on employers and two taxes on employees. These taxes are used to finance the payment of old-age, survivor, and disability insurance benefits payable under Title II of the Social Security Act and to finance the costs of hospital and related post-hospital services incurred by social security beneficiaries as provided in Part A of Title XVIII of the Social Security Act.

The employee's share of FICA taxes is measured by the amount of wages received with respect to employment. The term "wages" generally means pay received by an employee for employment covered by the Social Security Act, unless the pay is excluded specifically by law (Reg. § 31.3121(a)–1). The term "employment" includes all nonexempt service, of whatever nature, performed by an employee for the person employing him or her (Reg. § 31.3121(b)–3). An employer must withhold the employee's share of FICA taxes from the employee's wages when paid (secs. 3102 (a) and (b)).

For calendar year 1982, employers and employees are each required to pay FICA tax of 6.70 percent on the first $32,400 of an employee's wages (for a maximum of $2,170.80 each).[5]

FUTA tax

The Federal Unemployment Tax Act (secs. 3301–3311) imposes a tax on employers. FUTA tax revenues are used to pay all of the administrative costs of the Federal and State unemployment compensation programs and to help finance the payment of benefits to unemployed insured workers.

The FUTA tax is levied on covered employers at a current rate of 3.4 percent on wages of up to $6,000 a year paid to an employee (sec. 3301). However, a 2.7 percent credit against Federal tax liability is provided to employers who pay State taxes under an approved State unemployment compensation program (sec. 3302). For employers in States which have an approved unemployment compensation program, the effective FUTA tax rate is 0.7 percent (a maximum of $42 per employee).

The FUTA tax generally applies to an employer who employs one or more employees in covered employment for at least 20 weeks in the current or preceding calendar year or who pays wages of $1,500 or more during any calendar quarter of the current or preceding calendar year. In addition, certain agricultural labor and domestic services constitute covered employment for purposes of the FUTA tax.

Income tax withholding

In addition to the responsibility for FICA and FUTA taxes, an employer who pays wages to individual employees must withhold a

[5] The current FICA tax rate is scheduled to increase to 7.05 percent in 1985, 7.15 percent in 1986, and 7.65 percent in 1990.

portion of the wages to satisfy all, or part, of the employee's Federal income tax liability (sec. 3402).

The definitions relating to employment for purposes of income tax withholding are similar to the FICA and FUTA definitions. The term "employer" generally is defined as any person for whom an individual performs any service as an employee. An "employee' is an individual who performs services subject to the control of an employer, both as to what shall be done and how (Reg. § 31.3401(c)–1). The term "wages" is defined generally as all remuneration, unless specifically excluded, for services performed by an employee for the employer, including the cash value of all remuneration paid other than in cash (sec. 3401(a)).

2. Self-employed individuals

The Self-Employment Contributions Act (Code secs. 1401–1403) imposes two taxes on self-employed individuals. The SECA taxes finance the cost of old-age, survivors, and disability insurance benefits payable under Title II of the Social Security Act, as well as the cost of hospital and related post-hospital services incurred by social security beneficiaries (as provided for in Part A of Title XVIII of the Social Security Act).

The taxes levied under SECA, and the amount of income which may be credited toward benefits or insurance coverage, are based on an individual's self-employment income. The term "net earnings from self-employment" generally means the sum of: (1) the gross income derived by an individual from any trade or business carried on by such individual, less allowable deductions attributable to such trade or business, and (2) the individual's distributive share of the ordinary net income or loss from any trade or business carried on by a partnership of which the individual is a member.

The term "self-employment income" excludes net earnings from self-employment in any taxable year if such earnings are less than $400.

For calendar year 1982, a self-employed individual must pay SECA tax at a rate of 9.35 percent on net earnings of up to $32,400 (for a maximum SECA tax of $3,029.40).[6] Although the SECA tax rate (9.35 percent) is higher than the rate applicable to an employee's share of FICA tax (6.70 percent), it is lower than the combined employer-employee FICA rate (13.4 percent).

There is no Federal income tax withholding with respect to self-employment income. A self-employed individual may be required to file a declaration of estimated income tax if his or her gross income for the year reasonably can be expected to include more than $500 from sources other than wages (sec. 6015). However, no declaration is required if the amount of estimated tax for the year reasonably can be expected to be less than $200.[7] Also, each individual with $400 or more of net earnings from self-employment for the year must file a return showing the self-employment tax due (sec. 6017).

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[6] The SECA tax rate currently is scheduled to increase to a rate of 9.90 percent in 1985, 10.00 percent in 1986, and 10.75 percent in 1990.

[7] The estimated tax payment threshold is scheduled to increase in annual increments of $100 until it reaches $500 for 1985 and subsequent years.

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C. Judicial Remedies in Employment Tax Disputes

The U.S. Tax Court does not have jurisdiction over disputes involving employment taxes (sec. 6211). Thus, after assessment of an employment tax, the only judicial remedy ordinarily available to a taxpayer is payment of the tax, followed by a refund suit in a U.S. district court or the U.S. Court of Claims (after September 1982, the U.S. Claims Court).

Since employment taxes are "divisible,"[8] however, a taxpayer generally may challenge an employment tax assessment merely by paying the tax for one worker for one quarter, and then suing for a refund of that tax.[9] Generally, such a refund suit also would include a claim for an abatement of the unpaid, but previously assessed, taxes. The Service ordinarily would counterclaim in the litigation for the balance of the assessment. This procedure allows a resolution of employment tax issues without payment of the full amount of the employment tax assessment prior to litigation.

[8] That is, they are predicated on the employment of an individual for a calendar quarter.

[9] See, e.g., *Marvel* v. *U.S.*, 548 F.2d 295 (10th Cir. 1977).

III. BACKGROUND OF LEGISLATIVE PROPOSALS

A. Increase in Controversies Over Employment Tax Status

As a result of increased employment tax examinations in the late 1960's, controversies developed between some businesses and the Internal Revenue Service as to whether certain groups or types of workers who had long been treated as independent contractors should be classified as employees for Federal tax purposes. If the Service were to prevail in retroactively classifying such workers as employees, then the business would become liable for previously unpaid employment taxes—i.e., Federal income tax withholding, social security (FICA) taxes, and unemployment (FUTA) taxes—for all open years.

Many of these businesses argued that proposed classifications of certain workers as employees involved changes of positions previously taken by the Service in interpreting how the common law rules applied to their workers or industry. One example of what many taxpayers believed to be a controversial change of position involved two 1976 revenue rulings dealing with real estate salespersons. Rev. Rul. 76–136 [1] held that securities and real estate salespersons, remunerated solely on a commission basis, are not employees where, although provided office facilities and supplies, they are required to pay their own expenses and are not required to work under supervision, attend meetings, or work specified hours. Rev. Rul. 76–137 [2] held that real estate salespersons, remunerated solely on a commission basis, are employees of a real estate company where they are registered by the State in the name of the company, may receive a draw against commissions, may be required to submit reports and attend sales meetings, and may be discharged for failure to sell a minimum amount of property. Both of these rulings were revoked in 1978.[3]

B. Consequences of Reclassifying Workers

Overview

If a worker who has been treated as an independent contractor is determined retroactively to be an employee, four general tax consequences may follow:

(1) The business whose workers are reclassified may be assessed FICA and FUTA employment taxes for years not barred by the statute of limitations.

(2) Overpayments of income taxes may occur if the business is required to pay amounts as withholding of employee income tax liabilities with respect to which workers already had paid income tax (through estimated tax payments or with their returns).

[1] 1976–1 C.B. 312.
[2] 1976–1 C.B. 313.
[3] Rev. Rul. 78–365, 1978–2 C.B. 254.

(3) Overpayments of social security taxes may occur if the business is required to pay FICA taxes with respect to workers who already had paid self-employment (SECA) taxes.

(4) The retirement plan of the business may be disqualified.

Withholding

If a worker reclassification occurs, the employer generally is responsible for all employment tax liabilities (income tax withholding, both the employer's and the employee's share of FICA taxes, and the FUTA taxes) with respect to the reclassified worker. Federal income tax withholding assessments may be adjusted if the reclassified worker pays (or has paid) the proper amount of income tax (sec. 3402(d)). However, the employer may not be relieved of any applicable penalties or additions to tax for failure to timely pay over amounts as withholding.

FICA tax

Unlike the liability for income tax withholding, the reclassified worker's share of FICA tax often is not adjusted to reflect the amount of SECA tax already paid on the same income. This is because present law (sec. 6521) authorizes a FICA–SECA offset only if the worker who has been reclassified as an employee is prevented from filing for a refund of the SECA tax paid in error. This may result in the double collection of the employee's portion of social security tax: (1) once from the business as the FICA tax it initially failed to withhold from the reclassified employee, and (2) once from the employee as the SECA tax previously paid in error, if the employee could obtain a SECA tax refund but fails to do so.

Retirement plans

The reclassification also may have adverse effects on self-employed (H.R. 10) retirement plans. If the individual previously had received a determination from the Service that he or she was an independent contractor and then was reclassified as an employee, the retirement plan would be frozen and any future contributions to the plan would not be exempt from tax. If the individual previously had not received such a determination, the plan would be disqualified and all amounts in the plan (previous contributions plus income) then would be taxable. Furthermore, if an employer previously had established a qualified retirement plan for some workers whose status as employees was recognized, and the Service subsequently reclassified as employees additional workers whom the employer had been treating as independent contractors, the previously qualified retirement plan for the employees could be disqualified for failure to meet the minimum coverage requirements (sec. 410(b)).

C. Tax Reform Act of 1976

The conferees on the Tax Reform Act of 1976 requested that, until completion of a study by the staff of the Joint Committee on Taxation on the problems of classifying workers for tax purposes, the Internal Revenue Service should not apply "any changed position or any newly stated position which is inconsistent with a prior general audit posi-

tion in this general subject area to past, as opposed to future, taxable years * * *."[4] The Joint Committee on Taxation previously had asked the General Accounting Office (GAO) to examine the Service's administration of employment taxes, including the classification of individuals as employees or independent contractors.

D. GAO Recommendations

In its 1977 report, the GAO concluded that the principal problem with regard to classification of individuals for employment tax purposes is the uncertainty in the interpretation and application of the governing common law rules.[5] Based on its survey of industries and workers, the GAO concluded that uncertainty and controversies most frequently arise in cases in which an individual operates a business that is separate from, or subordinate to, another business that the Service may consider to be the individual's employer.[6]

The GAO recommended that the owner of a separate business entity should be excluded from the common law definition of employee if the owner:

(1) has a separate set of books and records which reflect items of income and expenses of the trade or business;

(2) has the risk of suffering a loss and the opportunity of making a profit;

(3) has a principal place of business other than at a place of business furnished by the persons for whom the owner performs or furnishes services; and

(4) holds himself out in his own name as self-employed or makes his own services generally available to the public.

An employer-employee relationship would exist, under the GAO recommendations, if an individual met fewer than three of these tests. If an individual met three of the four tests, the common law criteria would be used to determine employment status. The GAO further recommended that, absent fraud, the Service should be prevented from making a retroactive employee determination if the business annually obtains from the workers it classifies as self-employed signed certificates stating that they meet the separate business entity criteria and the business annually provides the Service with the names and employer identification or social security numbers of all certificate signers.

In order to alleviate the problem of double collection of social security taxes on the same income, the GAO recommended that the Service be authorized to reduce the employee portion of FICA taxes assessed

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[4] H.R. Rep. No. 94–1515, 94th Cong., 2d Sess. (1976), at 489. The Joint Committee staff report, "Issues in the Classification of Individuals as Employees or Independent Contractors" (JCS–5–79, February 28, 1979), provided an explanation of the common law rules governing employment status, a description of the source of employment tax status controversies, and a review of prior Congressional action. The report also discussed some of the interests and concerns of the parties involved in employment tax controversies, and analyzed how present law treats those parties and how several alternatives might affect them.

[5] Report of the Comptroller General to the Joint Committee on Taxation, "Tax Treatment of Employees and Self-Employed Persons by the Internal Revenue Service: Problems and Solutions," GGD–77–88, November 21, 1977.

[6] Examples of such cases would include sales through an independent agency of another party's products, or the subcontracting of work from a prime contractor.

against employers by an appropriate portion of the self-employment taxes (SECA) paid by reclassified workers for the open statute years.

E. Ways and Means Task Force—95th Congress

A Task Force on Employees/Independent Contractors, of the Committee on Ways and Means, chaired by Mr. Rangel, studied the classification problem during August and September, 1978. Because of the short time that then remained in the 95th Congress for resolving the complex issues involved in this problem, the Task Force adopted an interim measure for consideration by the full Committee, with an accompanying report.[7]

The Task Force bill (H.R. 14159, 95th Cong.) provided relief from employment tax liability for taxpayers involved in employment status controversies unless the taxpayer had no reasonable basis for not treating workers as employees. Eligible taxpayers were relieved of all liability for Federal income tax withholding, social security (FICA), and unemployment taxes (FUTA) with respect to workers for any period ending before January 1, 1979, during which such workers were not treated as employees. The bill also relieved taxpayers prospectively, through December 31, 1979, of potential tax liabilities based upon employment status classifications, unless the taxpayer had no reasonable basis for not treating the workers as employees. In addition, the bill prohibited the Service from publishing, prior to January 1, 1980, any regulation or revenue ruling with respect to the employment tax status of individuals.

The provisions of the Task Force bill were adopted by the Congress as part of the Revenue Act of 1978.

F. Revenue Act of 1978

General rules

During consideration of the Revenue Act of 1978, the Congress decided that it would be appropriate to provide interim relief to taxpayers involved in employment tax status controversies with the Service until the Congress had time to resolve the complex issues involved in that area. Section 530 of the 1978 Act provided such relief by: (1) terminating certain employment tax liabilities for periods ending before January 1, 1979; (2) allowing taxpayers who had a reasonable basis for not treating workers as employees in the past to continue such treatment for periods ending before January 1, 1980, without incurring employment tax liabilities; and (3) prohibiting the issuance, prior to 1980, of regulations and revenue rulings on common law employment status.

The temporary prohibitions on employment tax status reclassifications and on the issuance of new rulings or regulations by the Service were extended, by P.L. 96–167, through December 31, 1980. These prohibitions were again extended, by P.L. 96–541, through June 30, 1982.

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[7] House Comm. on Ways and Means, Comm. Print 95–104, 95th Cong., 2d Sess. (1978).

Prohibition on reclassifications

The 1978 Act allows a taxpayer to treat its workers as independent contractors (through June 30, 1982, pursuant to the extensions) unless there is no reasonable basis for that treatment. The taxpayer must file all Federal tax returns (including information returns) that are required to be filed with respect to workers whose status is at issue on a basis consistent with the taxpayer's treatment of the workers as independent contractors.

The 1978 Act established three alternative statutory standards which, if met, provide a reasonable basis for treating a worker as an independent contractor. The first standard is met if the taxpayer's treatment of a worker as an independent contractor is due to reasonable reliance upon judicial precedent, published rulings, technical advice with respect to the taxpayer, or a ruling issued to the taxpayer. The second standard can be met by showing reasonable reliance upon a past IRS audit of the taxpayer. The third statutory method for establishing a reasonable basis for treating a worker as an independent contractor is to show that such treatment coincides with a longstanding, recognized, practice of a significant segment of the industry in which the worker whose status is at issue is engaged.

The three statutory methods for fulfilling the Act's requirement that the taxpayer have a reasonable basis for treating a worker as an independent contractor are not exclusive. That is, a taxpayer may be able to demonstrate a reasonable basis for treating a worker as an independent contractor in some other manner.

Prohibition on rulings and regulations

The Act prohibits the Service from issuing any regulation or revenue ruling that classifies individuals for purposes of employment taxes under interpretations of the common law. However, this prohibition does not apply to the issuance of private letter rulings requested by taxpayers, or of regulations or revenue rulings that do not involve application of common law standards.

G. Carter Administration Proposal

In 1979, the Carter Administration submitted a proposal that consisted of income tax withholding on independent contractors, strengthened information reporting requirements, and the substitution of a 10-percent penalty tax for an employer's withholding tax liability.

This proposal was developed largely in response to a study, which the IRS undertook beginning in the fall of 1978, of income and social security tax compliance by workers treated as independent contractors. Among other things, that study indicated that approximately 47 percent of all workers who are treated by payors as independent contractors do not report any of their compensation.[8]

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[8] See, "Independent Contractors: Hearings on H.R. 3245 Before the Subcommittee on Select Revenue Measures of the Committee on Ways and Means," 96th Cong., 2d Sess. (1979) (statement of Hon. Donald C. Lubick, Assistant Secretary of Treasury for Tax Policy).

Withholding

Under the proposal, tax would have been withheld, at a flat rate of 10 percent, from payments made in the course of a payor's trade or business for services provided by certain independent contractors. No withholding would have been required on payments to an individual who normally provided (or who expected to provide) similar services to five or more payors during the calendar year. Furthermore, no withholding would have been required from a worker who expected to owe less tax than the amount to be withheld.

Flat-rate withholding would have applied to salespersons whose compensation for services was based upon the difference between the price to them of merchandise sold and its resale price. Compensation, for purposes of withholding upon those salespersons, would have been measured by the difference between the suggested (or estimated) selling price to the customers for the products and the purchase price paid by the salespersons.

Strengthened information reporting requirements

Penalties for failure to file information returns would have been increased to 5 percent of payments not reported, with a minimum penalty of $50. Furthermore, payors would have been required to provide copies of information returns to payees.[9]

10-percent penalty tax

In lieu of withholding tax liability, an employer whose workers were reclassified as employees would have been liable for a penalty tax equal to 10 percent of the amount of wages not withheld upon. The employer would have remained liable for the employer's half of FICA taxes and for FUTA taxes. Employees would have remained liable for their half of FICA taxes.

Differences in social security tax burdens

Although not a part of its proposal, the Carter Administration also believed that correcting the disparity between the FICA and SECA tax rates should be considered in the future as part of the broader issue of social security financing.

H. Ways and Means Subcommittee Bill—96th Congress

H.R. 5460 (The Independent Contractor Tax Act of 1979) was introduced by Mr. Rostenkowski on September 28, 1979. Other proposals [10] relating to the treatment of individuals for employment tax purposes were considered in executive session by the Subcommittee on Select Revenue Measures of the Committee on Ways and Means on September 20, October 10, 19, and 26, and November 27, 1979. H.R.

[9] This requirement was adopted in the Economic Recovery Tax Act of 1981 (P.L. 97–34). Furthermore, the penalties for failure to file most information returns (or provide statements to payees) were increased to $10 per failure, subject to a maximum of $25,000 for any calendar year.

[10] These included H.R. 3245 (96th Cong.) and proposals made by the Carter Administration, which were the subject of hearings before the Subcommittee on Select Revenue Measures of the Committee on Ways and Means, on June 20, July 16, and July 17, 1979.

5460 was ordered reported, with amendments, to the full Committee by a 5–4 vote on November 27, 1979. No further action was taken with respect to the bill.

H.R. 5460 would have provided an elective statutory test ("safe-harbor") for determining the status of individuals for purposes of the Federal employment tax laws. In addition, it would have broadened the information reporting requirements and would have increased the penalties for failure to comply with those requirements. Furthermore, it would have imposed withholding, at a flat-rate of 10 percent, on payments to certain independent contractors and would have provided a new penalty for unreasonable failures to withhold.

Except for the effective date, H.R. 5460 is identical to H.R. 5867. (For a description of H.R. 5867, see Part IV. D.)

IV. DESCRIPTION OF BILLS*

A. H.R. 4531—Messrs. Conable, Duncan, Frenzel, Jenkins, Martin (of N.C.), and others

Overview

H.R. 4531 would provide a statutory safe-harbor test for determining the status of individuals for Federal employment tax purposes and would give the Tax Court jurisdiction to hear certain employment tax disputes.

Explanation of Provisions

Safe-harbor test

The bill would provide a statutory safe-harbor test for determining an individual's Federal employment tax status. For an individual to qualify as an independent contractor under the bill, five requirements would have to be met. These requirements involve control of hours worked, place of business, investment or income fluctuation, written contract and notice of tax responsibilities, and the filing of required returns.

Failure to qualify as an independent contractor under the safe-harbor criteria would not affect an individual's classification under the common law tests. Thus, individuals who are independent contractors under the common law tests would not have their status reexamined or otherwise be affected by the bill's safe-harbor requirements, even if they failed to meet those requirements. The bill also would provide that, except in the case of certain employer-provided fringe benefits, the fact that the safe-harbor criteria are met and an individual is not an employee for purposes of self-employment taxes (chapter 2), social security taxes (chapter 21), Federal unemployment taxes (chapter 23), and Federal income tax withholding (chapter 24) would not create any inference that the individual is not an employee and the service-recipient (person for whom the service is performed) is not an employer for purposes of any other provision of law.

The safe-harbor test would not apply to individuals who are agent-drivers, commission-drivers, full-time life insurance salesmen, home-workers, and traveling or city salesmen.

The first safe-harbor requirement under H.R. 4531 would be met if the individual controls the aggregate number of hours worked and substantially all of the scheduling of the hours worked. In determining whether the control-of-hours test is met, conformance with government regulatory requirements, operating procedures and specifications of the service-recipient pursuant to contract, or coordination of the

performance of the service imposed by persons other than the service-recipient would be disregarded.

The second requirement could be fulfilled in any one of three alternative ways. It would be fulfilled if: (1) the individual does not maintain a principal place of business; (2) the individual maintains a principal place of business that is not provided by the service-recipient; or (3) the individual maintains a principal place of business that is provided by the service-recipient and pays rent therefor. For purposes of this requirement, an individual would be deemed to have no principal place of business if he does not perform substantially all the service at a single, fixed location.

The third requirement would be met if the individual either (1) has a substantial investment in assets used in connection with the performance of the service or (2) risks income fluctuations because more than 90 percent of the remuneration (whether or not paid in cash) for the performance of the service is directly related to sales or other output [1] rather than to the number of hours worked. Under this requirement, an individual would be deemed to have a substantial investment in assets if he or she furnishes the asset or assets customarily used in the performance of the service and is entitled to a depreciation allowance or investment credit with respect to such asset or assets, or is entitled to a business expense deduction for renting the asset or assets (provided the property has a useful life of three years or longer).

The fourth requirement provides that the individual must perform the service pursuant to a written contract with the service-recipient which provides that the individual will not be treated as an employee with respect to such service for purposes of the Federal Insurance Contributions Act, the Social Security Act, the Federal Unemployment Tax Act, and income tax withholding, and for purposes of certain employee benefit provisions.[2] This written contract would have to be

*Three of the bills described in this section (H.R. 4531, H.R. 5867, and H.R. 6311) also contain provisions which are directed specifically toward improving the income and employment tax compliance of independent contractors. Those provisions are described in JCX–18–82, "Comparative Description of the Provisions of H.R. 6300, H.R. 5829, H.R. 6311, and H.R. 5867 Relating to Expanded Information Reporting Requirements for Payments to Nonemployees, Increased Penalties for Failure to Report Certain Information, and Withholding," which was prepared in connection with a hearing on compliance issues held by the Ways and Means Committee on May 18, 1982. The penalty provisions of H.R. 4531 are similar to those contained in H.R. 5867.

[1] The term "other output" would include the performance of services but would not include piecework.

[2] These benefits are the statutory exclusions provided under Code secs. 79 (relating to group-term life insurance purchased for employees), 101(b) (relating to employee's death benefits), 104, 105, and 106 (relating to accident and health insurance or accident and health plans), 120 (relating to group legal service plans), and 127 (relating to educational assistance plans), and under subtitle A (relating to contributions to or under a stock bonus, pension, profit-sharing, or annuity plan and with respect to distributions under such a plan, or by a trust forming part of such a plan).

entered into before the performance of services.[3] In addition, the individual would have to be provided with written notice that is designed to ensure that the individual understands his or her responsibilities with respect to the payment of Federal self-employment and income taxes. This notice could be provided either in the contract or at the time the contract is executed.

The fifth requirement would be met if the service-recipient complies with the information return filing requirements with respect to payments to independent contractors.

Tax Court jurisdiction

H.R. 4531 would give the Tax Court jurisdiction to hear disputes involving employment taxes (other than railroad retirement taxes) resulting from the reclassification as employees of individuals who had been treated as independent contractors.

Special rule for certain traveling or city salesmen

The bill would extend Federal income tax withholding to remuneration paid to traveling or city salesmen who are treated as employees for FICA tax purposes.

Effective Date

The provisions of H.R. 4531 would apply to payments after June 30, 1981.

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[3] A special rule would apply to contracts entered into before June 30, 1981. For those contracts, the written contract and notice requirement would be satisfied if the contract clearly indicates that the individual is not an employee and the individual was notified, prior to August 31, 1981, of his or her responsibilities with respect to the payment of Federal self-employment and income taxes.

B. H.R. 4971—Mr. Crane (of Ill.)

Overview

H.R. 4971 would establish three alternative tests for determining the status of individuals for purposes of the Federal employment tax laws. An individual would qualify as an independent contractor if all the requirements of any one of the tests are met.

The first test contains five requirements relating to the control of hours worked, place of business, investment or income fluctuation, written contract and notice of tax responsibilities, and the filing of required returns. The second test contains six requirements which involve investment in assets, ownership or lease of assets, maintenance of assets, incidence of costs, responsibility for personal services, and contracts. The third test contains one requirement relating to the number of an individual's payors.

The failure to qualify for independent contractor status under the three tests set forth in the bill would not be construed to infer that service is performed by an employee or that the person for whom the service is performed is an employer. The tests would not apply, for purposes of social security taxes, to individuals who are agent-drivers, commission-drivers, full-time life insurance salesmen, homeworkers, or traveling or city salesmen.

Explanation of Provisions

First test

This test contains five requirements, all of which would have to be met for an individual to qualify as an independent contractor.

The first requirement would be met if the individual controls the aggregate number of hours actually worked and substantially all of the scheduling of the hours worked.

The second requirement could be met in any one of three alternative ways. This requirement would be satisfied if: (1) the individual does not maintain a principal place of business; (2) the individual maintains a principal place of business that is not provided by the person for whom the service is performed; or (3) the individual maintains a principal place of business that is provided by the person for whom the service is performed and pays rent therefor. The individual would be deemed not to have a principal place of business if he or she does not perform substantially all the service at a single, fixed location.

The third requirement would be satisfied if the individual either (1) has a substantial investment in assets used in connection with the performance of the service, or (2) risks income fluctuation because the remuneration with respect to the service is directly related to sales or other output rather than to the number of hours actually worked.

The fourth requirement provides that the individual must perform the service pursuant to a written contract with the person for whom the service is performed. The contract must provide that the individual will not be treated as an employee with respect to the service for purposes of the Federal Insurance Contributions Act, the Social Security Act, the Federal Unemployment Tax Act, and Federal income tax withholding. This contract would have to be entered into before the performance of the service.[4] In addition, the individual would have to be provided with written notice, either in the contract or at the time the contract is executed, of his or her responsibilities with respect to the payment of self-employment and Federal income taxes.

The fifth requirement would be satisfied if the person for whom the service is performed files any information returns required with respect to such service under Code section 6041(a).

Second test

The second test under H.R. 4971 would be fulfilled if, with respect to the service performed, each of the following requirements is met:

(1) the individual has a substantial investment in the assets used to perform the service;

(2) the individual owns the assets, or holds them under a bona fide lease agreement;

(3) the individual is responsible for the maintenance of the assets;

(4) the individual bears the principal burden of the operating costs of the assets (including fuel, repairs, supplies, insurance, and personal expenses) while engaged in the performance of the service;

(5) the individual is responsible for supplying the personal services necessary in the performance of the business; and

(6) the individual performs the service pursuant to a written or oral contract with the person for whom the service is performed.

The failure by an individual to file any return with respect to remuneration received for the service involved would not disqualify the individual under this test, unless the failure is willful or intentional.

Third test

The third test under H.R. 4971 would be met with respect to the service performed by any individual in any taxable year if the individual performed similar services for five or more payors during the preceding calendar year, or objective circumstances indicate that the individual can reasonably expect to perform services for five or more payors during the taxable year.

[4] A special rule would apply to contracts entered into before January 1, 1983. For these contracts, the written contract and notice requirement would be met if the contract clearly indicates that the individual is not an employee and the individual was given notice, prior to January 1, 1983, of his or her responsibilities with respect to the payment of Federal self-employment and income taxes.

Report by the Treasury Department

The bill would require the Treasury Department to submit to the tax-writing committees a report on the tax compliance of individuals who are treated as independent contractors under the bill. This report would be due no later than January 1, 1986.

Effective Date

H.R. 4971 would apply to services performed after December 31, 1981.

C. H.R. 5729 [5]—Messrs. Gephardt, Duncan, Bafalis, and others

Overview

H.R. 5729 would provide a statutory safe-harbor test (consisting of five specific requirements) for determining the status of individuals for purposes of the Federal employment tax laws. The bill contains a no-inference rule providing that if an individual failed to meet any one of the five tests, the classification would be governed by present common law rules. In addition, for purposes of social security taxes, the bill would not apply to individuals in certain specified occupations.

Explanation of Provisions

Safe-harbor test

To be classified as an independent contractor under the bill, the following requirements would have to be met:

(1) The individual must control the aggregate number of hours actually worked and substantially all of the scheduling of the hours worked.

(2) The individual must not maintain a principal place of business or, if the individual does so, the principal place of business must not be provided by the person for whom such service is performed; or, if it is so provided, the individual must pay such person rent for it. For purposes of this requirement, the individual would be deemed not to have a principal place of business if he or she does not perform substantially all the service at a single fixed location.

(3) The individual either must have a substantial investment in assets used in connection with the performance of the service, or must risk income fluctuations because the remuneration with respect to such service is directly related to sales or other output rather than to the number of hours actually worked.

(4) The individual must perform service pursuant to a written contract with the person for whom service is performed which was entered into before performance of the service. The contract must provide that the individual will not be treated as an employee for purposes of employment taxes, and provide the individual with written notice of his or her responsibilities for payment of self-employment and income taxes.[6]

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[5] The bill is similar to S. 8 (97th Cong.), sponsored by Senator Dole and others, and H.R. 3245 (Mr. Gephardt and others) (96th Cong.). H.R. 3245 was the subject of a hearing before the Ways and Means Subcommittee on Select Revenue Measures on July 16 and 17, 1979. S. 736 (the predecessor in the 96th Congress of S. 8) was the subject of a hearing before the Senate Finance Subcommittee on Taxation and Debt Management Generally on September 17, 1979.

[6] A special rule would apply to contracts entered into before January 1, 1983. For these contracts, the requirement would be satisfied if the contract clearly indicates that the individual is not an employee and if the individual is notified, prior to January 1, 1983, of his or her responsibilities with respect to the payment of self-employment and income taxes.

(5) The person for whom service is performed must file required information returns.

No-inference rule

H.R. 5729 contains a no-inference rule which provides that if the five requirements are not met with respect to any service, nothing in the bill shall be construed to infer that the service is performed either by an employee or for an employer, and that the determination of employment status issues is to be made as if the bill had not been enacted. Thus, if an individual failed to meet any one of the requirements, the individual's classification would be governed by the present common law rules.

Special rule for certain individuals

The bill provides that, for purposes of social security taxes, the safe-harbor test would not apply to individuals who are agent-drivers, commission-drivers, full-time life insurance salesmen, homeworkers, and traveling or city salesmen.

Effective Date

H.R. 5729 would apply to services performed after December 31, 1981.

D. H.R. 5867—Mr. Guarini

Overview

H.R. 5867 would provide a statutory safe-harbor for determining the status of individuals for purposes of the Federal employment tax laws.

Except for the effective date, H.R. 5867 is identical to H.R. 5460 (Mr. Rostenkowski and others), 96th Congress, as approved by the Subcommittee on Select Revenue Measures. (See also, Part III. H.)

Explanation of Provisions

Safe-harbor test

The bill would provide a statutory safe-harbor test for determining whether an individual is classified as an independent contractor. An individual who meets five requirements would be classified as an independent contractor, regardless of the individual's status under the common law rules. A failure by an individual to meet any one of the five requirements would not automatically result in classification as an employee. Instead, the individual could seek classification as an independent contractor under the common law.

The safe-harbor requirements of the bill relate to (1) control of hours; (2) place of business, assets, or sales; (3) income fluctuation; (4) written contract and notice of tax responsibilities; and (5) the filing of required returns.

(1) Control of hours

The first requirement would be met if the individual controls the number of hours worked and substantially all of the scheduling of those hours.

(2) Place of business, etc.

The second requirement would be fulfilled if any one of the following conditions is met: (1) the individual has a principal place of business which is not in the individual's personal residence (unless a portion of the residence is used exclusively and on a regular basis as the individual's principal place of business) and which is not provided by the service-recipient (payor); (2) more than one-third of the value of the service provided by the individual [7] is attributable to tangible property furnished by the individual; or (3) the individual is a salesperson who is an insurance agent, a licensed real estate agent, or a direct seller.[8]

(3) Income fluctuation

The third requirement would be fulfilled if the individual risks income fluctuation because more than 90 percent of the individual's remuneration is directly related to sales or other output (but not piecework) rather than to the number of hours worked. In the case of services performed after December 31, 1983, more than 95 percent of remuneration would be required to be directly related to sales or other output.

(4) Contract, notice

The fourth requirement would be fulfilled if the individual performs service pursuant to a written contract with the service-recipient which provides that the individual will not be treated as an employee with respect to such service.

(5) Returns

The fifth requirement would be that the service-recipient must file all required information returns.

Other related rules

The safe-harbor test would not apply to any individual described in sec. 3121(d)(3) (i.e., certain agent-drivers, full-time life insurance salesmen, home workers, and traveling or city salesmen). Relationships not meeting all requirements of the safe-harbor test would be classified under the common law rules, as if the safe-harbor had not been enacted. Qualification as an independent contractor under the safe-harbor test

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[7] The "assets" test of the second safe-harbor requirement contains several special rules.

A vehicle used primarily to transport the individual and any tools, etc., would not be taken into account. Moreover, an asset that is leased from, or the financing of which is assisted by, the service-recipient also generally would not be taken into account. However, a special rule provides qualification for the leasing (or financing) of a truck tractor from the service-recipient if the lease (or financing arrangement) is on terms and conditions comparable to those available on the open market. Assets leased from someone other than a service-recipient would be treated as tangible property furnished by the individual if the term of the lease is long in relation to the useful life of the asset.

Finally, for purposes of determining whether more than one-third of the value of services is attributable to tangible property, the payment of maintenance costs and fixed operating costs with respect to the property would be treated as the furnishing of property.

[8] A "direct seller," for purposes of the second safe-harbor requirement, would be an individual engaged in direct sales to consumers of products of a supplier, most of which are sold by direct sales in the home.

for purposes of Federal employment taxes and withholding would create no inference with respect to other laws.

Finally, individuals who qualify for independent contractor status under the safe harbor would be denied the statutory exclusions for employer-provided group-term life insurance, death benefits, accident and health benefits, group legal services, educational assistance plans, and pension, profit-sharing, stock bonus, or annuity plans.

Withholding for certain traveling or city salesmen

The bill would extend Federal income tax withholding, at graduated rates, to remuneration paid to traveling or city salesmen who are described in Code section 3121(d)(3)(D). (Under present law, these individuals are treated as employees for purposes of social security taxes and unemployment compensation taxes.)

Effective Date

The bill would apply to payments made after June 30, 1982.

E. H.R 6311—Messrs. Gephardt, Conable, Heftel, and Hance

Overview

H.R. 6311 (The Independent Contractor Tax Classification and Compliance Act of 1982) would provide a statutory "safe-harbor" test under which certain workers are treated as independent contractors for Federal employment tax purposes.

H.R. 6311 is nearly identical to S. 2369, which was the subject of a hearing on April 26, 1982, by the Subcommittee on Oversight of the Internal Revenue Service of the Senate Committee on Finance.[9]

Explanation of Provisions

Safe-harbor test

The bill would establish a safe-harbor test that, if satisfied, results in the classification of an individual as an independent contractor for Federal employment tax purposes. The safe-harbor test would have five requirements, all of which would have to be met for an individual to be treated as an independent contractor under the bill. These requirements relate to (1) control of hours worked, (2) place of business, (3) investment or income fluctuation, (4) written contract and notice of tax responsibilities, and (5) the filing of required returns.

(1) Control of hours worked

The first requirement would be met if the worker controls both the aggregate number of hours worked and also substantially all of the scheduling of those hours. In determining whether an individual controls the scheduling of hours worked, limitations on scheduling would be disregarded if they result from government regulatory requirements, from operating procedures and specifications which have been imposd on the person for whom service is performed (the "service-recipient") pursuant to contract with another party, from coordination of the performance of the service (by persons other than the service-recipient) with the performance of other services, or the control of access to any premises by the service-recipient if the individual controls the scheduling of hours when access is granted.

(2) Place of business

The second requirement would be met if no principal place of business of the worker with respect to the service was provided by the service-recipient. (Accordingly, the requirement would be met if the individual had no principal place of business with respect to the service.) However, the fact that the service-recipient provided a principal place of business with respect to the service would not cause the in-

[9] See, "Background on Classification of Employees and Independent Contractors for Tax Purposes and Description of S. 2369" (JCS–11–82, March 19, 1982).

dividual to fail this requirement if the individual paid a fair rental to the service-recipient.

A special rule would provide that even though a place of business was provided by the service-recipient, it would not be treated as a principal place of business if substantially all the service were performed at some other place of business that is not provided by the service-recipient.

(*3*) *Investment or income fluctuation*

The third requirement could be met in either of two ways.

First, the investment or income fluctuation requirement would be met if the worker had a qualifying investment in tangible assets which the individual used in connection with the performance of the service. To qualify, the assets would have to be of significant value in the performance of the service, and the individual's investment in the assets would have to be substantial in light of the nature and amount of the remuneration received for the service. For purposes of this asset investment test, an investment in a vehicle that is used primarily to transport the individual (and any tools, samples, or similar items) would not be taken into account.

Alternatively, this third requirement would be met if the worker risked income fluctuations because more than 90 percent of the remuneration for the performance of the service was directly related to sales or other output (including the performance of services, but not including piecework) rather than to the number of hours worked.

(*4*) *Written contract and notice of tax responsibilities*

The fourth requirement would be met if both (a) the individual performed services pursuant to a written contract (entered into before performance of the service) which expressly provided that the individual would not be treated as an employee for purposes of employment taxes, income tax withholding, and certain employee benefit provisions, and (b) the individual was given written notice (in the contract, or at the time the contract was executed) of his or her tax responsibilities for payment of Federal self-employment and income taxes.

The bill provides a special rule for written contracts entered into before January 1, 1983. A pre-1983 written contract would meet the fourth safe-harbor requirement (written contract and notice) if both (1) the contract clearly indicated that the individual was not an employee (e.g., by specifying the individual is an independent contractor) and (2) the notice of tax responsibilities was provided prior to January 1, 1983.

(*5*) *Filing of required returns*

This requirement would be met if the service-recipient filed all required information returns with respect to payments made to the worker, unless the failure to do so was due to reasonable cause and not to willful neglect.

Effect on other laws

A relationship which did not satisfy the safe-harbor test under the bill would be classified under common law rules, as if the safe-harbor test had not been enacted.

Qualification as an independent contractor under the safe-harbor test of the bill generally would create no inference with respect to status under provisions of law other than Federal employment tax provisions. However, individuals who qualified as independent contractors under the safe-harbor test for employment tax purposes could not be treated as employees for purposes of tax provisions relating to employer-provided group-term life insurance, death benefits, accident and health benefits, group legal services, educational assistance plans, dependent care assistance programs, and pension, profit-sharing, stock bonus, or annuity plans. This latter rule would not apply in the case of certain pre-1983 services (see discussion of Effective Dates, below).

Nonapplication to certain individuals

The safe-harbor test would not apply to certain agent-drivers or commission-drivers, full-time life insurance salespersons, certain home workers, and full-time traveling or city salespersons who generally are classified under present statutory law as employees for FICA tax purposes.

Effective Dates

The safe-harbor test of the bill generally would apply to services performed after the earlier of June 30, 1982, or the date of enactment. However, the written contract requirements would apply only with respect to services performed after December 31, 1982. Furthermore, with respect to services performed after the date of enactment (or after June 30, 1982) and before January 1, 1983, if an individual performing services were treated as an employee, then the safe-harbor test would not apply to those services.

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